ECONOMIC TRENDS AND OUTLOOK: INDONESIA 1998

Summary

Indonesia was widely hailed as a leading economic success story as recently as mid-1997. Real GDP growth averaged over 7 percent per year for the decade since 1987. GDP per capita surpassed US$ 1,000 by 1996, compared with US$ 70 in 1965. The rupiah was stable. Annual inflation was reported in the single digits. Foreign capital was pouring in.

The economic crisis that began in July 1997 changed all that. Indonesia experienced severe drought, low world petroleum prices, regional financial instability, domestic social unrest, and, ultimately, a change of government. By mid-1998, the government estimated that real GDP would contract 13 percent during 1998; private analysts projected a decline as large as 25 percent. GDP per capita had declined to US$ 450. The exchange rate plummeted from 2,450/US$ in June 1997 to 15,000/US$ a year later. Exchange rate volatility made business planning all but impossible. Annual inflation was running at an estimated 80 percent and the potential for higher inflation remained a worry. Foreign capital had fled, closing off access to new foreign lending, while the business sector struggled to service existing foreign debts at increasingly unfavorable exchange rates. Most observers agreed that the economy had not yet bottomed out as of mid-1998, making it difficult to chart a path toward recovery.

The shock waves from this sudden reversal of fortune reverberated among a generation familiar only with economic growth. The reversal cast into stark relief weaknesses that were downplayed during the preceding high growth period, including presidential succession uncertainty, corruption, collusion, and nepotism, a weak banking sector, and the large but then-unknown amount of foreign commercial debt. As employment dropped and prices rose, the loss of purchasing power, particularly among lower income groups, raised concerns about the ability of the population to feed itself and about the potential for social unrest. In may 1998, after fuel prices were increased and demonstrating students were shot, riots and looting swept Jakarta and

other cities, leading to the May 21 resignation of President Soeharto, who was replaced by his Vice President, B.J. Habibie. President Habibie announced that presidential elections would be held in December 1999.

The deep financial, economic, and political crisis that developed during 1997-98 obscured underlying strengths of the Indonesian economy. With a population of 201 million, the world's fourth largest country was the anchor of Southeast Asia and a sizable market with an emerging middle class. Its strategic location, large labor force earning relatively low wages, abundant natural resources, financial and trade sector deregulation efforts, and stable political climate had unleashed a domestic and foreign investment boom and fueled the development of a robust manufacturing economy concentrated on the main island of Java. Once dependent on petroleum, natural gas, and commodities including coffee, tea, spices, timber, and shrimp, Indonesia by 1997 exported US$ 45 billion in non-petroleum, labor-intensive products such as garments, footwear, plywood, and basic machinery, on top of its US$ 12 billion in oil and gas exports. It had also become a significant market and imported US$ 5 billion in goods from the United States in 1997.

Challenges for the Habibie Government

The list of challenges facing the new Habibie government in mid-1998 was daunting:

- The financial sector was in dire condition. Many major banks were surviving only because of direct government liquidity support, most loans were thought to be non-performing, and public confidence in banks was low. A major overhaul of the financial sector was just beginning, and it was not clear how many banks would emerge from it or how recapitalization of banks would be funded.

- The external debt burden was a drag on confidence and recovery. Indonesian private banks and businesses owed roughly US$ 73 billion to foreign creditors, and the Indonesian government owed another US$ 66 billion. Private bank and corporate debt rescheduling talks were underway, but were likely to be protracted, meaning that there would be a delay in the resumption of foreign lending to Indonesian businesses. Lack of offshore trade financing was hindering export growth. Sovereign debt rescheduling was under discussion.

- The real sector continued to contract, leading to concerns about massive unemployment. Each week brought additional reports of firms cutting back or ceasing operations, as inputs became unavailable and demand slumped. Construction sites stood idle and factories empty. An estimated 9 million persons in the wage-earning economy were unemployed as of April 1998, and the number was expected to reach 13 million by the end of the year, up from 4 million at the end of 1997.

- The food situation was a growing concern, more in terms of affordability for lower income groups than of availability. The government was subsidizing prices of essential commodities such as rice, but the subsidies had become a serious drain on the government budget, and food price increases continued. Though reliable statistics were unavailable, the share of the population in poverty was increasing.

- The government's budget deficit was expected to reach 8-10 percent of GDP in fiscal year 1998/99 (April-March).

- The political climate remained uncertain. The Habibie government appeared to be consolidating its hold on the machinery of government, but there was wide disagreement within society about its legitimacy and about how the political reform process should proceed. General parliamentary elections were scheduled for mid-1999, to be followed by parliament's election of a president in December 1999.

- The riots of mid-May 1998 remained a traumatic issue, particularly for the ethnic-Chinese minority who dominate Indonesia's modern economy.

Although Indonesia still had many of the factors that fueled its earlier growth – abundant natural resources, a large and literate population, a modest birth rate, and modern infrastructure – and had begun to introduce economic reforms, the timing of economic recovery remained uncertain. As poor as conditions were, few observers believed that economic activity had bottomed out. Recovery appeared likely to be a painful, years-long process. An overriding issue was the restoration of sufficient confidence to encourage domestic businesses and foreign investors to resume their activities.

U.S. Business Interests - On Hold

The substantial range of U.S. business interests in Indonesia was adversely affected by the deep crisis. Many major infrastructure projects, including independent power projects sponsored by U.S. and other foreign investors, were on hold. Contractors supplying petroleum, natural gas, and electricity to government agencies were not being paid reliably. U.S. banks and other creditors were grappling with unpaid loans to Indonesian banks and companies (though U.S. exposure was small in comparison to that of Japan and Europe). Investors were scaling back manufacturing operations or delaying projects. The high level of uncertainty surrounding Indonesia's immediate future led most U.S. businesses, like other foreign firms, to adopt a wait-and-see attitude. U.S. firms by and large said they were committed to Indonesia for the long haul.

The political and economic reform process that was beginning in May 1998 offered hope that Indonesia will emerge from the crisis with a business climate that is more open and transparent, and therefore more favorable for U.S. firms. Longstanding monopolies, including those controlled by the Soeharto family, were beginning to be dismantled. Limits on foreign ownership of a range of businesses, including banks and retail sales networks, were slated to be removed. Public calls to eliminate "collusion, corruption, and nepotism" were putting pressure on the government to tackle the "high cost economy." At the same time, the depth of the economic contraction led some observers to fear that social unrest could recur and derail the reform process, further delaying economic recovery.

Response to the Crisis -- The IMF Program

To respond to the worsening economic situation in Asia, the Soeharto government initially took bold measures including floating the rupiah in August 1997 and reducing budget outlays in September 1997. By October 1997, declining conditions led Indonesia to request IMF support. The Indonesian government signed its first letter of intent to the IMF on October 31. The letter called for a three-year economic recovery program, supported by loans from the IMF (US$ 10 billion), the World Bank, the Asian Development Bank, and bilateral donors. Apart from financial support the international community was offering detailed technical assistance to the government. Governments and private organizations were also contributing food and other humanitarian assistance.

Indonesia's agreement with the IMF was revised January 15, 1998, April 10, June 24, and July 29 in response to deteriorating macroeconomic conditions. The result is a complex, multi-faceted program to address macroeconomic imbalances, financial weaknesses, real sector inefficiencies, and the loss of private sector confidence. The latest versions of the program expanded the focus of the earlier programs to cover the entire spectrum of economic challenges facing Indonesia: (1) fiscal policy; (2) monetary policy; (3) structural reform and deregulation; (4) corporate debt and bankruptcy proceedings; (5) banking sector reform and restructuring; (6) restoration of trade financing to promote exports, and (7) food security, the distribution system, and social safety net policies.

Fiscal Policy

The Indonesian government has historically maintained a "balanced" budget: expenditures were covered by the sum of domestic revenues and foreign borrowing, without resort to domestic borrowing. Often the government ended the year with a slight surplus. This fiscal year (April 1998-March 1999), the gap between domestic revenues (shrinking because business was moribund, and because oil prices were low) and expenditures (skyrocketing, because of subsidies for basic goods) will be large, perhaps 8.5 percent of GDP or over US$ 8 billion. The challenge for the government was to balance the need for continued subsidies on essential goods against the need for fiscal prudence. Foreign financing was considered key to maintaining that balance. In July 1998, the international financial institutions and bilateral donors pledged an extraordinary increase in financial support to Indonesia for social safety net outlays.

Monetary and Exchange Rate Policy

In parallel with its fiscal policy, the Indonesian government earned a reputation for prudent monetary policy in recent years that helped keep consumer price inflation in the single digits (see Table 1). However, the massive depreciation of the rupiah that began in mid-1997 (after the government decided to let the rupiah float freely rather than deplete its reserves in an effort to defend the rate) and huge liquidity injections into the banking system contributed to significant inflation (see Table 2). The Indonesian monetary authorities attempted to dampen inflationary pressure and reduce pressure on the exchange rate by controlling the growth of the money supply (see Table 3).

Table 1. Historically Low Inflation and Slow Depreciation

	Rp/US$	CPI Inflation, %/Year
1992	2,030	4.9
1993	2,087	9.8
1994	2,161	9.2
1995	2,249	8.6
1996	2,342	6.5
1997	2,909	11.1

Source: Bank Indonesia

Inflationary pressures remained a serious potential threat, because of the large budget deficit and continuing depreciation of the rupiah. Moreover, prices remained low by purchasing power parity standards, even after a 47 percent consumer price index (CPI) increase during January-June 1998. The alternative to price increases – disappearance of certain goods from the market as producers sought higher prices abroad – was complicating the supply situation for certain essential goods including cooking oil.

Table 2. Significant Month-On-Month Inflation in 1997-98

	Rp/US$	CPI Inflation % per Mo.	Rp % OF 7/97 Value in USD Terms
July-97	2,599	0.7	100%
August-97	3,035	0.9	86%
September-97	3,275	1.3	79%
October-97	3,670	2.0	71%
November-97	3,648	1.7	71%
December-97	4,650	2.0	56%
January-98	10,375	6.9	25%
February-98	8,750	12.7	30%
March-98	8,325	5.5	31%
April-98	7,970	4.7	33%
May-98	10,500	5.2	25%
June-98	14,850	4.6	18%

Source: Bank Indonesia

Table 3. Changes in Base Money and Broad Money, Rp Trillions, July 1997-June 1998.

	Base Money	Change On Prev. Mo.	Broad Money	Change On Prev. Mo.
July-97	39.9	-1%	317.5	1%
August-97	33.3	-16%	325.9	3%
September-97	36.6	10%	329.1	1%
October-97	33.6	-8%	340.7	4%
November-97	33.8	1%	330.6	-3%
December-97	46.1	36%	355.6	8%
January-98	56.0	22%	450.7	27%
February-98	49.6	-11%	430.2	-5%
March-98	59.4	20%	449.8	5%
April-98	61.1	3%	453.4	1%
May-98	67.8	11%	493.9	9%
June-98	70.4	4%	N/A	N/A

Note:

M2 Includes Foreign Currency Deposits, so Changes Are Partly The Result Of Exchange Rate Shifts.

Source: Bank Indonesia

Exchange rate policy went through several phases after the government eliminated the rupiah intervention band (which allowed limited fluctuation of the exchange rate) in August 1997. First, the government adopted a high rupiah interest rate policy to defend the exchange rate. The policy was effective (the rupiah only depreciated slightly in September 1997), but collateral damage to the domestic business sector was considered too painful. After lowering interest rates somewhat, the Indonesian government turned to direct intervention in the foreign exchange market in what it called an effort to stave off exchange rate volatility, rather than defend a particular rate. As depreciation continued – fueled by economic instability in South Korea, questions about President Soeharto’s health, and doubts about reform program implementation – the monetary authorities announced an end to the direct intervention policy, though occasional interventions appear to have continued. During early 1998, after the sudden plunge of the rupiah in January (see Table 2), President Soeharto considered setting up a currency board system, with a fixed exchange rate backed by foreign exchange reserves. The idea was ultimately abandoned. As of mid-1998, the government had returned to the high interest rate policy, and was intervening in the domestic money market to absorb excess liquidity. The exchange rate remained weak, however. Demand for dollars remained high with supply limited, and demand for rupiah was low. Most observers believed that political risk factors, rather than purely economic factors, were influencing the exchange rate.

Structural Reform and Deregulation

Although structural reforms were an important element of the program adopted in October 1997, the January 1998 revision increased emphasis on them, both to eliminate high profile distortions immediately and to set the stage for greater systemic efficiency in the longer run. External trade liberalization measures have been enacted. Perceived lack of progress in other reform areas, particularly on domestic trade and investment issues, in the early months of 1998 undermined confidence in the government’s will to carry the program out fully. The April 24 supplementary memorandum to the IMF spelled out structural commitments in greater detail and more progress was made. Indonesia pledged to eliminate monopolies and cartels; reform its wood sector; embark upon a program to privatize state enterprises; and eliminate many distortions in the agricultural and food marketing sectors, including a dramatic downsizing of the national logistics agency (BULOG). In the June and July memoranda, the Habibie government reconfirmed its intention to carry out the structural commitments made earlier. Major areas included:

- Monopolies and Cartels: Elimination of paper and wood cartels and the clove monopoly.

  Significant progress was made toward the elimination of monopolies and cartels, including those for cloves, paper, and plywood. After President Soeharto’s resignation, public attention to this issue grew under the banner of reform for the elimination of "corruption, collusion, and nepotism." As a result, additional monopolies not addressed under the IMF program but which caused significant economic inefficiencies were under review.

- Privatization: Privatization of at least seven state-owned enterprises and sale of additional shares in partially privatized companies; development of plans to improve the health of other state firms.

  This was politically sensitive in light of concerns that foreign interests would gain control of key economic assets and because of concerns about the fairness of the privatization process. Some progress was being made as of mid-1998. Minister for State-Owned Enterprises Tanri Abeng was moving to prepare state firms for privatization. Twelve international investment banks had been selected to assist in the privatization process. Firms slated for privatization included state-owned steel, toll road, airport management, mining, and plantation companies. Additional shares were to be sold in state-owned telecommunication, cement, and mining companies that had already been partially privatized through listings on the Jakarta Stock Exchange.

- Wood, Wood Products, and the Forestry Sector: Introduction of a resource rent tax on forestry products and reduction of export taxes on logs and timber; dismantlement of joint marketing boards for wood products and reforms of forestry concession ownership rules.

  Consistent with its commitments, Indonesia lifted its prohibitively high export taxes on the export of timber and logs and replaced them with a 30 percent export tax, though technical issues concerning this tax remained unresolved. Joint marketing boards for wood products were disbanded.

- Palm Oil: removal of quantitative restrictions on the export of crude palm oil (CPO) and derivative products and issuance of criteria for determining locational restrictions on investment in palm oil plantations.
  The government replaced the ban on palm oil exports with an export tax and issued criteria governing investment in plantations. The government also announced that revenue from the CPO export tax would be used to subsidize domestic cooking oil prices.

- Food Marketing/Bulog: Removal of Bulog import and distribution monopolies for all commodities except rice.

  Bulog monopolies were eliminated in theory. In practice, however, Bulog remained the sole importer of important commodities, in part because it had access to government exchange rate subsidies for the procurement of certain basic foodstuffs, including rice, soybeans, and wheat.

Corporate Debt and Bankruptcy

Indonesia’s offshore corporate debt turned the exchange rate crisis of 1997 into the full-fledged economic crisis of 1998. As of mid-1998, efforts to grapple with this core problem were still in an early stage, though the outlines of a debt-rescheduling scheme were in place.

When Indonesian corporations began borrowing abroad in significant numbers in the early 1990s, the trend was seen as a rite of passage for a maturing economy. The rationale for borrowing abroad was simple: domestic interest rates were much higher than foreign rates, and the modest, predictable depreciation of the rupiah exchange rate made the currency risk appear negligible. As Table 4 indicates, Indonesian corporations ran up over US$ 70 billion in debt, much of it short-term and most of it unhedged. Conversely, high domestic interest rates attracted a large amount of foreign portfolio capital into Indonesia (see "other capital" in Table 5). International lenders were keen to participate in Indonesia’s rapidly growing economy.

The downhill slide of the rupiah during the latter half of 1997 put most Indonesian borrowers (with the exception of those who had hedged their currency exposure, and those with foreign currency earnings) in a very difficult position. The collapse of the rupiah in early 1998 – which was in part fueled by the demand for dollars to pay short-term debt – combined with the slowing of economic activity, made their situation untenable. Further compounding the problem was the withdrawal of foreign portfolio capital from Indonesia, and the unwillingness of foreign lenders to roll over short-term loans as they had in the past. A vicious circle developed, where corporations' inability to pay debts, both domestic and foreign, crippled local banks and made foreign lenders unwilling to lend new money into Indonesia. Starved for working capital, the economy contracted sharply, making it more difficult for corporations to generate cash. The downward spiral had not abated as of mid-1998.

An Indonesian private debtors contact committee set up by the government in January 1997 proposed a "temporary pause" in offshore private debt payments while rescheduling was worked out, with the understanding that those companies that could continue to pay would do so. Between January and July, the debtor and creditor committees, with the participation of the Indonesian government and in concert with the IMF, worked out a three-part framework for addressing the private debt issue:

- Trade credit: the Indonesian government agreed that the arrears on trade credits from Indonesian banks to foreign banks (US$ 1-2 billion) would be repaid in full by end-June. In return, foreign banks would reinstate trade credit lines at their end-April levels (US$ 4-6 billion). As of mid-July, bankers reported that most of the trade arrears had been repaid, though some issues (payment of past-due interest, for example) remained to be settled.

- Exchange of interbank debt: a second part of the framework calls for foreign banks to exchange interbank loans due through March 1999 (US$ 8-9 billion) for loans with maturities of 1-4 years, backed by an Indonesian government guarantee. The plan was promoted in major cities abroad in July 1998, but foreign banks were hesistant to accept the plan as of late July.

Table 4. Indonesia: External Debt, As Of March 31, 1998

	US$ Billion
Public Sector	
Government	54.4
State-Owned Enterprises	
State Banks	
Bank Credit	5.0
Commercial Paper, etc.	0.6
Subtotal	5.6
Non-Bank Enterprises	
Bank Credit	3.8
Commercial Paper, etc.	1.7
Subtotal	5.6
Total Public Sector	65.6
Private Sector	
Banks	
Bank Credit	
Indonesian-Owned Banks	3.1
Joint-Venture Banks	4.3
Foreign-Owned Banks	0.4
Commercial. Paper, etc.	0.2
Subtotal	8.0
Corporations	

Bank Credit	
Foreign-Owned Firms	29.0
Domestic Firms	31.8
Commercial Paper, etc.	3.7
Subtotal	64.5
Total Private Sector	72.5
Total External Debt	138.0

Source: Bank Indonesia

Note: The Commercial Paper Category Also Includes Medium-Term, Floating-Rate, And Promissory Notes, And Certificates Of Deposit, All Owned By Non-Residents.

Table 5. Balance Of Payments, US$ Billions

	94/95	95/96	96/97	97/98	98/99
(Budget)					
Current Account					
Exports	42.16	47.75	52.04	56.16	56.55
Imports	-34.12	-41.50	-45.82	-42.70	-37.88
Services, Net	-11.53	-13.24	-14.29	-15.36	-17.24
Current Account Bal.	-3.49	-6.99	-8.07	-1.90	1.42
Financial Account					
Official Capital	5.65	5.73	5.30	8.49	18.15
Debt Repay (Principal)	-5.55	-5.94	-6.12	-4.10	-2.97
Other Capital	4.65	11.67	13.49	-10.36	-11.31
Total Balance	1.26	4.48	4.60	-7.86	5.29
Errors And Omissions	-0.62	-2.65	-7.35	-3.45	0.00
Monetary Movements	-0.65	-1.83	2.75	-10.02	-5.29
Official Reserves	13.32	15.98	19.87	N/A	N/A

Source: Ministry Of Finance

- Corporate Debt: the third part of the debt restructuring framework was the most complex and significant, covering US$ 65 billion in Indonesian corporate debt. Under the terms of a voluntary plan, the Indonesian government established the Indonesian Debt Restructuring Agency (INDRA) in August 1998 to guarantee the availability of foreign exchange at a market-determined exchange rate (the best 20-day-average over the entry period, August 1998-June 1999, with a possibility for adjustment if the exchange rate later strengthens), and to act as payment intermediary between debtors and creditors. The first step in the process is for debtors and creditors to agree individually on a debt rescheduling plan that will include a grace period on principal payments at least until end-December 2001, and a final maturity no earlier than end-December 2006. Debt forgiveness is not built into the overall plan, but is expected to be worked out on an individual basis. The next step is for debtors to buy foreign exchange from INDRA, either upon entry into the program, or in installments. Finally, INDRA is to make foreign currency payments to creditors in accordance with the rescheduling agreement.

In addition, a revision of the 1905 Bankruptcy Law was scheduled to take effect in August 1998, and was expected to provide an impetus for debtors to reach agreement with creditors. Concern over the effectiveness of the new bankruptcy code remained, however, because of the poor reputation of Indonesia's legal system as a whole.

Banking Sector Reform

Indonesia's banking sector was in dire condition as of mid-1998, and a major effort to restructure the sector was taking shape. Most bank loans were not being serviced; banks were in turn unable to service their debts; and the collapse in bank credibility had all but shut off the flow of interbank credit. The public's confidence in Indonesian banks was low.

After a decade of banking sector liberalization, the Government of Indonesia found itself forced to play an increasing role in banking as the economic crisis deepened. Bank Indonesia first provided a substantial amount of liquidity credits to banks (over Rp 140 trillion as of June 1998, or about 20 percent of 1997 GDP) – in effect becoming the part owner of many troubled banks – after several potentially disastrous runs on banks. As the extent of banking sector weakness became clear, the government established the Indonesian Bank Restructuring Agency (IBRA), charged with taking over and eventually recapitalizing ailing banks. The government also issued a sweeping guarantee on bank deposits and other liabilities.

Under the restructuring plan that was being worked out with the assistance of the International Monetary Fund, the World Bank, and the Asian Development Bank, the banks under IBRA supervision were to undergo full portfolio reviews by international accounting firms. An asset management unit (AMU) was being set up to take ownership of and then sell off non-performing assets. Viable banks were to be recapitalized – with foreign participation invited – while non-viable banks were to be closed. The scope of the task was enormous, because worsening economic conditions meant that previously sound banks continued to deteriorate along with the economy as a whole. Estimates were that over 50 percent of loans were non-performing. Observers believed that most of the banks not under IBRA supervision were in serious financial condition as well. Thus, it was difficult to estimate how many banks would remain after the restructuring process was complete.

Against the backdrop of bad news for the banking sector as whole, the conditions facing U.S. and other foreign banks in Indonesia were improving in terms of market access and national treatment, for two reasons. First, in December 1997, Indonesia submitted a far-reaching offer in the World Trade Organization financial services negotiations that, among other improvements, guaranteed the ownership rights of existing financial services firms. Second, partly in response the banking sector crisis, the government was preparing legislation that would allow full foreign ownership of existing Indonesian banks.

Trade Issues

Growth of the export sector has been a leading factor in Indonesia's rapid development. Total exports increased from US$ 20 billion in 1988 to US$ 56 billion in 1997, growing at an average rate of 21 percent per year over the period. As its diverse basket of non-oil exports increased in value (see Table 6), Indonesia markedly reduced its dependence on income from petroleum exports. In 1985 the oil and gas sector contributed 68 percent of export earnings and 60 percent of government revenues. By 1997, these figures were cut to 23 percent and 17 percent respectively. Leading the non-oil export boom were natural-resource based industries (plywood, rubber, copper) and labor-intensive manufactures (garments, furniture, shoes). Indonesia had not yet moved up to high-technology exports such as computer equipment, but was becoming known as a world-class exporter of paper and a growing source of basic machinery and electronics.

With the decline in domestic demand, strong export performance was essential for Indonesia's recovery. The depreciation of the rupiah should have increased export competitiveness. Many firms shifted their production toward exports in early 1998 for two reasons: domestic markets were drying up, and dollar-denominated export revenues, translated into rupiah, were extremely attractive. However, exporting firms were having trouble importing raw materials in early 1998 because foreign banks refused to accept

Table 6. Leading Exports, 1992-1997, US$ Billions

Category	1992	1993	1994	1995	1996	1997	Avg. Growth/Yr., 1992-97
Garments	3.2	3.4	3.1	3.3	3.2	4.2	5%
Plywood	3.2	4.1	3.7	3.5	3.5	3.5	2%
Textiles	2.5	2.3	2.5	2.9	2.7	3.4	7%
Elec. Appliances	1.0	1.3	1.8	2.7	3.6	3.3	26%
Pulp, Paper	0.4	0.5	0.8	1.5	1.4	2.0	37%
Palm Oil	0.5	0.5	0.9	1.0	1.0	1.7	29%
Copper	0.7	0.6	0.9	1.6	1.4	1.5	18%
Rubber	1.0	1.0	1.3	2.0	1.9	1.5	8%
Shrimp, Tuna Lobster	0.8	0.9	1.1	1.1	1.1	1.1	6%
Handicrafts	0.5	0.7	1.0	0.7	0.5	1.0	14%
Other Non-Oil Exports	9.4	11.7	13.4	16.8	17.8	21.5	18%
Oil/Gas Exports	10.5	9.6	9.9	10.5	12.2	11.7	2%
Total	33.8	36.6	40.2	47.5	50.2	56.3	11%

Source: Bank Indonesia

Table 7. Leading Non-Oil Exports, Jan-Apr 1997 vs. Jan-Apr 1998, US$ Billions

Category	Jan-Apr 97	Jan-Apr 98	% Change
Garments	1.05	1.20	15%
Plywood	1.17	0.87	-25%
Textiles	0.95	1.33	39%
Elec. Appliances	0.95	0.94	-1%
Pulp And Paper	0.46	0.80	73%
Palm Oil	0.35	0.10	-73%
Copper	0.57	0.32	-43%
Rubber	0.56	0.33	-41%
Shrimp, Lobst., Tuna	0.30	0.34	15%
Handicrafts	0.27	0.93	239%
Other Non-Oil Exports	5.84	6.73	15%
Total	12.47	13.89	11%

Source: Bank Indonesia

Letters of credit from Indonesian banks. The government addressed the problem in part by introducing a cash collateral facility: foreign banks had a total of US$ 1 billion in cash on deposit from Bank Indonesia with which to finance trade. In addition, the trade-finance agreement reached in Frankfurt (see section on corporate debt) was expected to lead to restoration of some trade lines. In July, the government designated 21 Indonesian banks to support trade finance. The U.S. export-import bank offered a US$ 1 billion short-term trade facility; other countries also worked to restore adequate levels of trade finance. As Table 7 indicates, the export picture was mixed as of early 1998, partly because of declines in world prices of commodities such as copper, but the dollar value of exports was increasing overall. Over the longer term, the export sector was expected to play an important role in the recovery.

Food Security and Distribution

Following 1997's El Nino induced drought, there was growing concern in 1998 that Indonesia's financial and economic crisis had the potential to become a humanitarian crisis if adequate food supplies were not made available at affordable prices. The significant price increases of essential commodities (see Table 8) occurred during a period when wages were generally flat and unemployment was increasing, making them especially burdensome for lower income groups. With the approval of the IMF, the government began subsidizing imports of rice and other essential commodities in early 1998. Bulog, whose role was supposed to be cut sharply as part of the liberalization of the real economy, instead expanded its role as food wholesaler for rice, soybeans, wheat, sugar and other commodities. The government provided exchange rate and consumer subsidies for basic commodities, incurring significant costs as the exchange rate continued to deteriorate. Apart from their burden on the budget, subsidies introduced other complications. In July 1998, the government imposed a temporary export ban on several subsidized goods in the wake of reports that large quantities of these goods were being shipped to neighboring countries. The export ban was scheduled to be replaced by export taxes in August 1998. Efforts were also underway to target the subsidies at lower income groups rather than across-the-board.

Table 8. Price Increases Of The Nine Essential Commodities, July 1997-April 1998

	Java	Non-Java
Rice	50%	37%
Salted Fish	56%	42%
Palm Oil	134%	80%
Granulated Sugar	36%	31%
Salt	66%	32%
Kerosene	8%	6%
Washing Soap	77%	72%
Textiles	38%	39%
Batiks	25%	30%
General	51%	39%

Source: Central Bureau Of Statistics

After riots in May 1998 that targeted ethnic-Chinese businesses in Jakarta and other cities, concerns arose that the Indonesian retail distribution system, operated in large part by ethnic-Chinese traders, might not function properly. As of July, however, most observers agreed that the distribution system was still operating, although it was hobbled by lack of credit, decreased demand and security concerns. The affordability of basic goods, rather than their availability, was the problem. In late July, the government offered rebuilding assistance to businesses that were destroyed in may, and offered assurances that businesses, warehouses, and trucks would be protected.

Negative Outlook for Major Sectors

In the sweeping economic crisis of 1997-98, contraction, rather than growth, was the order of the day. Preliminary figures for the first half of 1998 indicated that real GDP had declined 12 percent compared to the first half of 1997. As Table 9 indicates, the Indonesian Central Bureau of Statistics projected that real GDP would decline by 13 percent for the year, in marked contrast to real GDP growth of recent years (1993: 6.5 %, 1994: 7.5 %, 1995: 8.2 %, 1996: 8.0 %, 1997: 4.6 %). Private analysts and securities firms expected a real GDP decline as large as 25 percent. The domestic and regional economic uncertainties combined with political change made it difficult to predict when growth would resume.

The government expected a contraction in all major sectors, with the exception of negligible growth in agricultural output. The comparatively positive outlook for agriculture was significant because it was the largest employment sector, accounting for 41 percent of workers in 1997. Sectors with a significant export component (agriculture, mining) or receiving large subsidies (public utilities) were projected to do relatively better than others. At the opposite extreme was the construction sector, which was projected to contract 35 percent for the year.

Manufacturers faced a declining domestic market, mounting debts, difficulty obtaining trade credit or working capital, and, in some cases, labor unrest. Auto assembly and manufacturing, previously a rapidly growing area, suffered an 82 percent decline in sales during the first half of 1998, compared with the same period in 1997. Where possible, a shift toward exports was underway. An East Java lighting firm reported that it was exporting 75 percent of its output as of mid-1998, compared to 40 percent a year earlier.

In the trade sector, which includes hotels and restaurants, it was easy to find evidence of distress. Most four- and five-star hotels in Jakarta had percentage occupancy rates in the teens or low 20's as of mid-1998, down from the 70-percent range a year earlier.

In property and finance, the slowdown in overall activity led to declines in property prices and occupancy rates. Rental prices in Jakarta's prime shopping malls, traditionally priced in U.S. dollars, fell from US$ 80/m2/month in June 1997 to US$ 10 in June 1998. Jakarta office occupancy rates, already down to 87 percent in late 1997, reportedly dropped to 70 percent by June 1998. The banking sector was expected to continue to contract.

Table 9. Real GDP (1993 Prices) Rupiah Trillions

	1997	1998*	% Change
Agriculture	64	64	0.3%
Mining And Quarrying	38	36	-6.9%
Manufacturing	109	96	-12.0%
Electricity, Gas, Water	5	5	-2.2%
Construction	35	23	-35.4%
Retail And Wholesale Trade, Hotels, Restaurants	73	57	-21.4%
Transportation And Communication	32	28	-11.6%
Finance, Rentals, And Company Services	39	32	-18.6%
Services	38	36	-5.2%
GDP	434	377	-13.1%
GDP Excluding Oil/Gas	399	343	-14.1%

*Preliminary Projection, Based On Jan-Jun 1998 Data
Source: Central Bureau Of Statistics

Appendix A: Country Data

Population in 1997: 201 Million (Projection based on 1990 Census)
Population Growth Rate: 1.68 %/Year (avg. for 1990-97)
Religions: Islam, Hinduism, Buddhism, Christianity, Animism
Government System: Authoritarian/Transitional
Languages: Indonesian, English, and Regional Languages
Work Week: Monday - Friday

Appendix B. Domestic Economy

	1996	1997	1998 (EST)
GDP (USD Billions)	227	215	90
Real GDP Growth Rate (Percent)	9.0	5.0	-13.0
GDP Per Capita (USD)	1146	1070	448
Government Spending as Percent of GDP	18%	18%	28%
Consumer Price Inflation (Percent)	6.5	11.1	80.0
Unemployment (Percent)	4.9	4.7	N/A
Foreign Exchange Reserves (USD Billions)	25.5	21.4	N/A
Average Exchange Rate For USD 1.00	2,342	2,909	10,600
Debt Service Ratio (Debt Service/Exports)	43%	41%	N/A
U.S. Economic Aid (USD Millions) (1)	85	74	250

Appendix C: Trade (USD Billions)

	1996	1997	1998 (EST)
Total Exports (2)	50.2	56.3	12.5
Non-Oil/Gas (2)	38.0	44.6	10.2
Oil/Gas (2)	12.2	11.7	2.3
Total Imports (2)	44.2	46.2	7.2
U.S. Exports To Indonesia (Non-Oil/Gas) (3)	3.8	5.0	0.9
U.S. Imports From Indonesia (Non-Oil/Gas) (3)	7.4	8:0	3.6

Note 1: Pledged at Annual Consultative Group on Indonesia (CGI) Meeting
Note 2: 1998 Figure is Jan-Mar
Note 3: 1998 Figure is Jan-May
Sources: Bank Indonesia, Ministry of Finance, U.S. Commerce Dept.